Insurance Law Updates

By James M. Roth, Esq.
THE ROTH LAW FIRM

As 2012 came to a close, the Courts were apparently not looking to find new law. Rather, they are reaffirming well-settled principles. In this column we will analyze two California decisions venued in the federal courts and a decision by the Delaware Supreme Court applying California law.

IF AN INSURER IS TO AVOID LIABILITY FOR "BAD FAITH," ITS ACTIONS AND POSITION WITH RESPECT TO THE CLAIM OF AN INSURED, AND THE DELAY OR DENIAL OF POLICY BENEFITS, MUST BE FOUNDED ON A BASIS THAT IS REASONABLE UNDER ALL THE CIRCUMSTANCES.

In ***Bafford v. Travelers Cas. Ins. Co. of America*** (2012) 2012 WL 5465851, the United States District Court, E.D. California, held on November 8, 2012, that the failure to fully investigate the grounds for a denial may be unreasonable conduct exposing an insurer to "bad faith" liability.

Travelers issued James Bafford d/b/a "Car Doctor" a policy to insure property at his auto repair shop. During the policy term Bafford reported to Travelers that his shop had been burglarized, and his tools stolen. According to Travelers notes, Bafford's building had an alarm, but it was not set before the loss occurred. Travelers' notes also stated that the digital video recorder for Bafford's surveillance camera was stolen. During its loss investigation, Travelers requested documentation from Bafford including receipts, itemization of tools stolen, bank statements, work orders, and other information, most of which Bafford failed to produce. Travelers interviewed individuals who explained that Bafford had himself removed all of the items which were the subject of the loss. Travelers sent Bafford a letter reserving its rights under the insurance policy and the law, and requested a sworn statement of proof of loss, to which Bafford complied. Additionally, Bafford was subjected to an examination under oath Not long after the loss was reported, three Travelers employees sent among themselves a variety of internal communications: "Yeah definitely this guys *[sic]* is a liar. I really don't buy force *[sic]* entry on the door. He showed me a bunch of receipts of his equipment etc *[sic]* and looked like he prepared It *[sic]* well and prepared for a while. Guy was not looking me in the eye and he was nervous." "I know! Did you see how empty his shop is?" "I don't feel pressured. I just hope this witness talks because I want to nail this as much as you do." "It would be nice to nail that guy." "I just want to get this guy." Travelers denied Bafford's claim on the grounds that he had made material misrepresentations during the investigation and while being examined under oath.

When Travelers denied the claim, Bafford filed suit alleging that Travelers breached the contract by refusing to pay his claim, and breached the covenant of good faith and fair dealing both by failing to conduct a proper investigation, and by unreasonably delaying payment on his claim.

Travelers moved for partial summary judgment on the issues of whether it can be held liable to Bafford for breach of the implied covenant of good faith and fair dealing, and punitive damages. Travelers argued that its denial was justified given the timeliness and thoroughness of its investigation, which included inspections of Bafford's business premises; interviews of neighboring businesses; requests for documentation supporting Bafford's claimed losses; discussions with the local Police Department; obtaining witness statements; running a background check on third-party witness Dennis Bloom (who was one of the individuals interviewed); following up with businesses mentioned in Bafford's and Bloom's statements; and conducting an examination under oath of Bafford. Travelers further relied upon the alleged misrepresentations by Bafford during his examination under oath: he claimed that his stolen tools were in his shop for 5 days before the loss (while witnesses including Bloom claimed to have observed him removing tools and equipment shortly before the loss); he denied using a flatbed truck in his business, or borrowing a flatbed or trailer (while witnesses including Bloom observed him loading a flatbed trailer before the alleged loss); he said that the chain to his business had been cut when he discovered the loss (but had previously indicated that the lock has been cut); he claimed that the gate to his business was closed when he arrived on the morning of the loss (but according to the relevant police report, he had found the gate open); and he denied that he could monitor his surveillance system from home (but according to Bloom, had earlier bragged about being able to do so). Finally, Travelers relied upon "red flag" indicators triggering suspicions of fraud, such as losses of a large amount of cash; Bafford's provision of receipts for inexpensive items, but not items of significant value; and claimed losses apparently incompatible with Bafford's income.

The District Court denied Travelers' motion for partial summary judgment on Bafford's claim for breach of the implied covenant of good faith and fair dealing but granted Travelers' motion for partial summary judgment on Bafford's claim for punitive damages.

Following a detailed analysis of the law of "bad faith," the Court ended its narrative by noting that the ultimate standard is as follows: If an insurer is to

avoid liability for bad faith, its actions and position with respect to the claim of an insured, and the delay or denial of policy benefits, must be founded on a basis that is reasonable under all the circumstances. One form of objectively unreasonable conduct, explained the Court, is the failure to fully investigate the grounds for denial. To fulfill its obligations, an insurer must give at least as much consideration to the interests of the insured as it gives to its own interests and an insurer cannot reasonably and in good faith deny payments to its insured without fully investigating the grounds for its denial.

The Court found that the evidence suggested that Travelers concluded quite early in the investigation that Bafford had submitted a fraudulent claim and proceeded to seek information confirming that position. An insurer's early closure of investigation and unwillingness to reconsider a denial when presented with evidence of factual errors will fortify a finding of bad faith. Ten days after the loss was reported Travelers internal email noted that Bafford was probably "hiding the goodies" and that he was "definitely ... a liar." Less than two months after the loss, internal email opined that "It would be nice to nail that guy." A few days later, an email responded "I just want to get this guy." Perhaps most telling, observed the Court, was a Travelers file note that "we don't have much ground to stand on" without a statement from Bloom. It was reasonable to infer from these statements, explained the Court, that Travelers' investigators had made up their minds that Bafford had submitted a fraudulent claim and were seeking only confirming evidence.

Travelers separately argued that it was entitled to summary judgment under the "genuine dispute" doctrine: as it had a genuine dispute with Bafford as to coverage, it did not act in bad faith by delaying and then denying his claim. The Court swept that argument aside, finding that there was evidence that Travelers failed to adequately investigate Bafford's claim by not giving him an opportunity to explain why he removed equipment from his business two days before the alleged burglary.

A DISABILITY INSURER MAY NOT DEFEAT AN INSURED'S RIGHT TO A JURY TRIAL IN A DECLARATORY RELIEF ACTION WHEN THE CLAIM RAISED FACTUAL QUESTIONS PERTAINING TO THE INSURANCE POLICY, WHICH WERE LEGAL IN NATURE.

In ***Entin v. Superior Court*** (2012) 208 Cal.App.4th 770, the Court of Appeal, Second District, Division 7, held on August 20, 2012, that an insured has a right to a jury trial in a disability insurer's action for declaratory judgment because the claim raised factual questions pertaining to contractual rights, which were legal in nature.

Alleging that migraine headaches had rendered him incapable of performing the substantial and material duties of his occupation as an obstetrician and gynecologist, Dr. Allen Entin filed a claim for benefits under his disability policy. Dr. Entin's insurer, Provident Life and Accident Insurance Company, reviewed the claim and began paying him disability benefits under a reservation of rights. While continuing to pay benefits, Provident filed a declaratory relief action seeking a determination that Dr. Entin was not "totally disabled" within the meaning of the policy and thus not entitled to disability benefits. The complaint clarified that although Provident did not believe Dr. Entin was totally disabled, it would continue to pay his disability claim until the Court issued its determination of the rights and responsibilities of the parties.

A threshold issue in the declaratory relief action was whether Dr. Entin was entitled to a jury trial, which the California Constitution guarantees in a civil action at law, but not in equity. Dr. Entin argued that he had a right to a jury because the case raised factual issues concerning his entitlement to contractual insurance benefits. Provident, however, argued that there was no right to a jury because the underlying claim and relief sought — identification of prospective right under the insurance policies — are purely equitable in nature. Provident maintained that California precedents recognizing the right to a jury trial when an insurer seeks a declaration that no coverage exists do not apply when the insured cannot pursue a claim for breach of contract in lieu of the declaratory relief action. Provident argued that Dr. Entin could not sue for breach of contract here because Provident was continuing to pay benefits. Agreeing with Provident, the trial court ruled that Dr. Entin did not have a right to a jury trial.

The Court of Appeal reversed, holding that the proper inquiry was not whether Dr. Entin could have filed a counter-suit for breach of contract, but rather whether the issues raised in the declaratory relief action were legal or equitable in nature. The Court explained that if the "gist" of a declaratory relief action involves the resolution of factual issues pertaining to a plaintiff's contractual rights, the defendant is entitled to a jury regardless of whether that underlying legal claim remains "inchoate." Here, Dr. Entin's rights turned on whether his medical condition rendered him totally disabled; a question of fact that a jury must decide and which does not depend on the application of equitable doctrines.

The Court rejected Provident's contention that if the right to a jury trial attaches under the circumstances at issue, insurers will have no incentive to continue paying an insured benefits while simultaneously pursuing a determination of the parties' rights. "By agreeing to pay benefits until a declaratory judgment is rendered," the Court pointed out, "Provident has presumably insulated itself from (or at least bolstered its defense to) any tort claims predicated on the denial of those benefits."

The Court also rejected Provident's argument that its claim was parallel to a request for specific performance, which is

continued on page 12

continued from page 11

Insurance Updates

an equitable remedy. Nor, in the Court's view, did the absence of a claim for monetary damages preclude a right to a jury. Although the mode of relief is a factor that may be considered when assessing the right to a jury trial, it is not determinative. The mode of relief requested by Provident did not alter the legal nature of those rights, which turned on resolution of disputed factual questions.

INSURED'S SETTLEMENT WITH UNDERLYING INSURER FOR LESS THAN POLICY LIMITS PREVENTS RECOVERY UNDER EXCESS POLICY BECAUSE INSURED'S OUT-OF-POCKET PAYMENTS DO NOT EXHAUST UNDERLYING INSURANCE.

In a case originating from the state of Delaware, the Supreme Court of Delaware, applying California law in ***Intel Corp. v. American Guarantee & Liability Insurance Co.*** (2012) 51 A.3d 442, held on September 7, 2012, that an insured's out-of-pocket payment of defense costs do not count toward the exhaustion of policy limits for the purpose of triggering an excess policy which states that the insured must exhaust underlying coverage "by payment of judgment or settlements."

After spending more than $50 million defending antitrust lawsuits, Intel Corporation sought reimbursement of those costs and indemnity against liability from XL Insurance Company (XL) and American Guarantee & Liability Insurance Co (AGLI). XL provided the first layer of excess coverage with coverage limits of $50 million. Immediately above the XL policy was an excess liability policy issued by AGLI. Intel agreed to accept $27.5 million of XL's $50 million policy limits to settle its coverage dispute with XL. AGLI then contested coverage under its policy on the ground that Intel had not exhausted the limits of the underlying XL policy. Intel argued that the AGLI policy allowed the insured to exhaust underlying insurance by adding its own payments for defense costs to the underlying insurer's payments. Having paid the difference between the $27.5 million settlement and XL's $50 million policy limits out of its own pocket, Intel asserted that AGLI was obligated to provide coverage.

The Delaware Supreme Court's analysis was complicated by the fact that the AGLI policy contained two provisions concerning when AGLI's coverage obligations were triggered, one of which was in the insuring policy form the other was in an endorsement. Intel had attempted to find ambiguity in the complexity of the policy language, pointing out that the insurer's interpretation depended on the complex interplay of the insuring policy form, the endorsement, and the argument that no reasonably objective insured should be expected to understand the policy. The Court, however, thought otherwise, explaining that "[a] complicated policy does not mean . . . that there is no single reasonable interpretation of its language, or that every proffered interpretation will be a reasonable one."

Having determined that the provision in the endorsement controlled, the Court turned to the meaning of its language, which provided:

"Nothing contained in this Endorsement shall obligate us to provide a duty to defend any claim or suit before the Underlying Insurance Limits shown in Item 6 of the Declarations are exhausted by payment of judgments or settlements."

The controlling phrase, concluded the Court, was "payment of judgments or settlements." The Court explained that "California law does not provide a definitive interpretation of the phrase 'payments of judgments or settlements.' Although not dispositive of our holding, we note that California courts generally have construed the phrase to exclude cases where the insured 'credits' the underlying insurance carrier with the remaining policy limits. That is, courts have required the *actual* payment of the full underlying limits. The requirement of actual payment supports our plain meaning interpretation of 'judgments or settlements' to exclude Intel's direct payment of defense costs, and require actual payment by the insurer."

The Delaware Supreme Court relied upon the California decision in ***Qualcomm, Inc. v. Certain Underwriters At Lloyd's London*** (2008) 164 Cal.App.4th 184. The *Qualcomm* court held that an insured could not trigger its excess policy by paying the gap created when it settled with its primary insurer for less than full policy limits. The Delaware Supreme Court acknowledged that the exhaustion language in the policy in *Qualcomm* was slightly different than that contained in the AGLI policy, but it nevertheless found a general rule that the "[p]lain policy language on exhaustion, such as that contained in Paragraph C [of the AGLI policy], will control despite competing public policy concerns." >